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IN THE

Supreme Court of the United States

October Term, 1959.

No. 543.

THE PHILADELPHIA SAVING FUND SOCIETY,
Petitioner,

v.

THE UNITED STATES OF AMERICA,
Respondent.

PETITIONER'S REPLY BRIEF.

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1. The Petition for Certiorari has set forth the importance of the question presented; the implications of the decision, not only for banks receiving FDIC insurance dividends, but on the taxability of insurance dividends in general; the conflict of the decision below with the principles established by this Court in *Penn Mutual Life Insurance Company v. Lederer*, 252 U. S. 523; and the conflict with decisions of this Court and other circuits on the application of the "clearly erroneous" rule. Respondent's brief (dealing primarily with the merits) nowhere explains why it believes the issue is not of general importance, nor does it say why it believes the decision does not have the implications alleged in the Petition. Moreover, its statement (p. 6) that the Court of Appeals did not base its decision on the "clearly erroneous" rule is obviously incorrect, unless it is assumed that the Court did not mean what it said.

2. In its brief, Respondent quotes (pp. 6-7) Section 7(e) of the Federal Deposit Insurance Act and concedes that a

Section 7(e) refund or credit "clearly constitutes a recovery of a prior expenditure within the meaning of the tax benefit rule." Having made such a concession, it is impossible to logically then conclude that a credit under Section 7(d) is not the recovery of a portion of a prior assessment, while a refund or credit under Section 7(e) is. In both cases, the assessment being credited has previously become part of the assessment income of the FDIC. In attempting to distinguish between Sections 7(d) and 7(e) the Respondent quotes a part of 7(e) referring to refund of a payment of an "assessment in excess of" the amount due, and points out that 7(d), on the other hand, has to do with pro rata distribution of "excessive assessment income." This certainly is a distinction without a difference.

The FDIC itself recognizes that in this respect a credit under Section 7(e) is exactly the same as under Section 7(d), the only real difference being the occasion for granting the credit. Thus, in the FDIC Regulations, 12 C. F. R., Section 327.237, it is provided:

> "§ 327.237 *Assessment Decision No. 137; refunds of assessments.* (a) An overpayment of an assessment made by an insured bank is normally credited to its account and left to apply upon the assessment next becoming due. However, upon request from the bank a refund will be made of the overpayment of assessment.
>
> (b) An assessment credit, that is, the statutory credit allowed annually based upon the net assessment income for the preceding calendar year, cannot be refunded to operating banks since section 7(d) of the Federal Deposit Insurance Act specifically provides that assessment credits shall be applied upon future assessments. However, where the insured status of a bank has been terminated, refunds of all credits, including assessment credits, will be made to the insured bank after all requirements in respect to assessments

and the termination of its insured status have been met. In lieu of a refund, a bank whose deposit liabilities have been assumed by another insured bank may assign its unused credits to the assuming bank after all requirements on assessments and the termination of its insured status are met."

Accordingly, the FDIC deals with the treatment of assessment credits under the heading "refunds of assessments" and obviously considers that such credits, just as the Section 7(e) credits, are returns of previously paid assessments. Moreover, Section 7(d) itself makes no provision for a refund of assessment credits upon termination of the insured status of a bank. Yet, the FDIC in the foregoing Regulation treats the assessment credits for this purpose as actually being under Section 7(e), and provides for a cash refund upon termination of insured status.

3. Respondent cites in support of its position, *Commissioner v. Glenshaw Glass Company*, 348 U. S. 426, and *Burnet v. Sanford & Brooks Company*, 282 U. S. 359. However, neither of those cases involved the situation where a taxpayer in one year made an expenditure and in the subsequent year recovered the same expenditure, thus realizing no gain from the transaction. In the *Glenshaw* case, this Court specifically characterized the recoveries there involved as "undeniable accessions to wealth" and in footnote 8 distinguished rulings dealing with personal injury recoveries on the ground that such recoveries "are by definition compensatory only." And in *Dobson v. Commissioner*, 320 U. S. 489, this Court pointed out that the *Sanford & Brooks* case suggested its own distinction in that it did not involve a recovery of expenditures previously made. This was also pointed out in *Plumb, The Tax Benefit Rule Today*, 57 Harv. L. Rev. 129, f.n. 8, p. 130:

"Burnet v. Sanford & Brooks Co., 282 U. S. 359 (1931), is to be distinguished. There the recovery

stood in the place of the proceeds of a contract and was true gross income, even though in a loose sense it reimbursed the expenses of performance; the items here under consideration adjust or correct previous expenses or losses.''.

4. In its argument No. 2, Respondent contends that even if the 1952 credit constituted a recovery of a portion of the taxpayer's 1951 assessments, the credit is nevertheless taxable income because the only reason the taxpayer received no tax benefit was that it was previously exempt from taxation.

This argument of Respondent is based on the notion that the tax benefit rule is designed to compensate for the loss of a previous tax advantage (See p. 9 of Respondent's brief). This totally misconceives the concept of the tax benefit rule. The basis for the rule actually is that if in one year a taxpayer makes an expenditure, which he recovers in a later year, the recovery should be taxed if the same item has previously been deducted with tax benefit. Otherwise, the taxpayer would in effect receive the benefit of a deduction for an expenditure never in fact made. On the other hand, if there has been no previous deduction with tax benefit, the taxpayer comes out even, and taxing him would result in a tax on a transaction which resulted in no economic gain. Obviously, the reason for the lack of tax benefit in the earlier year is immaterial.

The Commissioner of Internal Revenue has recognized this very principle in Rev. Rul. 58-126, 1958-1 C. B. 13. It was there ruled that a mutual savings and loan association which transferred after 1951 an amount from its reserve for losses to undivided profits did not realize taxable income where such reserve was created from profits in years prior to 1952, when the association was exempt from tax and therefore received no tax benefit from the additions to reserve. On the other hand, where the transfers from reserve affected additions to the reserve in 1952 and there-

after, when the association was subject to income tax and deducted such additions to reserve, the ruling was that the transfers did result in taxable income.

In the present case, the Respondent in effect says that Petitioner should be thankful that if was altogether exempt from income tax prior to 1952, rather than complaining that the Government is attempting to tax it on a receipt which under general principles of tax law is exempt. In other words, Respondent would discriminate against Petitioner merely because it was once tax exempt.

Respectfully submitted,

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